

BILL ANALYSIS

C.S.H.B. 3191
By: Bailey
Economic Development
Committee Report (Substituted)

BACKGROUND AND PURPOSE

Based on random audits, the Texas Workforce Commission Tax Department has estimated that approximately \$12 - 13 million in yearly wages are not reported by employers due to misclassification of workers. This is a very conservative estimate, if for no other reason than audits are limited in nature and only conducted on employers who have already established an account with us to report wages for other employees. Those employers who never bother to establish a tax account and simply classify all their workers as independent contractors, arguably a very substantial number, are not included in this estimate. The true amount of unpaid taxes is certainly much higher. The IRS has estimated that as many as 15% of employers misclassify employees, As a result, 3.5% of all workers are inappropriately treated as independent contractors. If this is true, the tax avoidance in Texas alone could be upwards of \$60 million. A 2004 Department of Labor study on misclassification concluded that over \$200 million in taxes are wrongfully withheld nationwide. Texas's portion of that figure would be a more conservative \$15-\$20 million. Whatever the precise figure, the magnitude is considerable.

The widespread practice of misclassification of employees as independent contractors flourishes due to two reasons: ignorance of the law and the lack of meaningful penalties for its defiance. These causes reinforce each other.

CSHB 3191 proposes that a flat penalty equal to one year's tax on the employee be imposed. If malicious intent is shown, the penalty would be tripled. Thus, unreported wages on a full-time employee at the average tax rate would incur a penalty of \$156, if unintentional, and \$468 if bad faith is shown. At the minimum tax rate, the penalty would be \$52. At the maximum rate, \$722. If and only if bad faith and intent are proven, \$156 and \$2168, respectively, for the minimum and maximum tax rate on a fulltime employee.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the Texas Workforce Commission of the State of Texas in SECTION 3 (Section 234.104, Labor Code) of this bill.

ANALYSIS

SECTION 1. Amends Subchapter B, Chapter 213, Labor Code, by adding sections 213.026 to read as follows:

Section 213.026. PENALTY FOR MISCLASSIFICATION OF EMPLOYEE. (a) Requires that an employer trying to avoid tax liability or reporting requirements for any person in its employment by denoting or treating such person as an "independent contractor," "contract labor," or any other term or category implying the absence of an employment relationship, shall pay an established penalty in addition to interest due or tax on the employee's wages. (b) Provides that the employer pay a separate penalty for each employee. (c) Establishes the amount of the penalty. (d) Establishes the amount of the penalty if the employer specifically receives the final decision that the individual is indeed an employee of the employer.

SECTION 2. Amends Section 234.101, Family Code, by adding Subsection (3) which defines "independent contractor."

SECTION 3. Amends Sections 234.102 and Section 234.104, Family Code, to read as follows:

Section 234.102. OPERATION OF NEW HIRE DIRECTORY. Amends existing statute to include each newly hired or rehired independent contractor.

Section 234.104. PROCEDURES. Authorizes Texas Workforce Commission by rule shall establish procedures for reporting independent contractor information and for operating a state directory of new hires meeting the requirement of federal law.

SECTION 4. Provides that only conduct occurring on or after the effective date of this Act applies to this Act.

SECTION 5. Provides the effective date of this Act.

EFFECTIVE DATE

This Act takes effect immediately, if this Act does not receive the necessary vote, this Act takes effect on September 1, 2005.

COMPARISON OF ORIGINAL TO SUBSTITUTE

The original bill, as filed, was not a Legislative Council draft, therefore, the committee substitute was drafted by Legislative Council and does the following:

1. Conforms the bill to the appropriate sections of the Labor Code:

Substitute places the language in Subchapter B, Chapter 213, Labor Code is amended by adding Section 213.026 as opposed to amending and adding Sections 213.015 and 213.016.

2. Conforms the bill into the proper legal language.